Financial Markets

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Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

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Coming soon to a depository institution near you: contemporaneous reserve accounting (CRA)! No, banks are not showing horror films, although the mere thought of CRA is scary to some bankers. But on February 2, 1984, the beginning of the first reserve maintenance period under CRA, we will find out which genre of drama the Fed is presenting: Alfred Hitchcock-type horror films or a remake of William Shakespeare's Much Ado About Nothing. Strange bedfellows though these are, I believe we will have bits of each.

For those of you who perceive Fed policy as being equivalent to the Fed funds rate, much of the ado will go unnoticed. The funds rate may be a bit more volatile, but the Fed has been holding it in a narrow trading range, and that objective will likely continue. However, this hint of greater volatility gets at the core of the problem with CRA: The Fed will find it much harder to fine tune reserve availability. There is a potential for great rate volatility.

This potential is seen most clearly by those of us who closely track reserve movements and the Fed's open market operations. The Fed uses open market operations of various sorts to affect reserves. Under the system currently in place--lagged reserve accounting--the Fed knows the amount of reserves required by banks because the reserve calculation period begins two weeks ahead of the maintenance period. Under CRA, however, the reserve calculation period precedes the reserve maintenance period by just two days--not two weeks. Hard and fast reserve figures aren't available until right at the end of the maintenance period. In addition, the Fed has lengthened the reserve calculation and maintenance periods to two weeks. This means that net free/net borrowed reserve statistics can be calculated only biweekly. There will be only one settlement day (still Wednesday) every two weeks.

The upshot of these changes is that both banks and the Fed will probably have to do a great deal of forecasting to get reserves right. Alternatively, banks that choose not to forecast their required reserves and instead adjust to past reserves data (the two-day head start accorded the reserve calculation period would facilitate this) will encounter some difficulty. For instance, before weekends banks would be holding reserves on Friday based on Thursday's data. That's a problem if the required reserves for each of these two days aren't the same, because reserves held Friday are also held Saturday and Sunday. Thus the weekend is a triple threat. The magnitude of weekend errors would become known only the next week when "scrambling" and rate volatility might occur.

As for the Fed, it really needs to know what procedure banks are using in order to forecast their reserve needs. If the Fed is concerned with stabilizing the Fed funds rate, it will need to know at all points during the statement period what quantity of reserves banks desire to hold. This usually differs from banks' required reserves --at least before settlement day. Banks that forecast are more likely to tolerate reserve imbalances. Banks that "see too much uncertainty" to forecast will likely respond more frantically to perceived reserve imbalances. Thus in addition to estimating required reserves each period, the Fed will need to think about how banks will formulate their own guesses about reserve requirements: Stabilizing the funds rate is not necessarily easy under CRA.

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Market Yields

	1/27/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00	11.00%	11.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.25
Federal Funds	9.25	9.44	8.25
Repurchase Agreements	9.05	9.30	8.25
U.S. Treasury Issues			
Bills			
3 months	9.24	9.24	8.31
6 months	9.50	9.53	8.55
1 year	9.79	9.89	8.87
Coupons			
2 years	10.61	10.59	9.48
4 years	11.10	11.11	10.02
7 years	11.49	11.53	10.59
10 years	11.59	11.61	10.66
Long Bond	11.69	11.70	10.82
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.25	9.25	8.30
3 months	9.35	9.35	8.50
6 months	9.45	9.50	8.80
1 year	9.90	9.95	9.00
Banker's Acceptances			
1 month	9.25	9.30	8.35
3 months	9.38	9.47	8.50
6 months	9.57	9.64	8.85
Eurodollar Deposits			
1 month	9.69	9.63	9.00
2 months	9.75	9.69	9.13
3 months	9.81	9.81	9.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.29	9.40	8.38
1 month	9.40	9.45	8.42
3 months	9.49	9.49	8.54
Bank Holding Companies			
1 month	8.94	8.94	8.17
Dealer Placed:			
3 months	9.52	9.60	8.55
New AA Corporate Utility Bond	12.80	12.75	12.65
Tax Exempt			
6 month Project Notes	5.20	5.25	4.50
1 year AAA Bond	5.40	5.50	5.25
5 year AAA Bond	6.80	7.00	6.30
20 year AAA Bond	8.90	9.00	8.80

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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